



**USAID** | **ARMENIA**  
FROM THE AMERICAN PEOPLE

# FOSTERING SMALL BUSINESS GROWTH

Micro Enterprise Development Initiative Final Report

**30 SEPTEMBER 2006**

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc.







A photograph of two men in a workshop. The man in the foreground, wearing a light-colored short-sleeved shirt, is leaning over a workbench and working on a piece of wood. The man in the background, wearing a blue long-sleeved shirt, is also working. The workshop has a rustic appearance with wooden beams and various tools and materials visible.

# MICRO ENTERPRISE DEVELOPMENT INITIATIVE

MEDI Final Report

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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.





# CONTENTS

EXECUTIVE SUMMARY .....	I
THE EMERGENCE OF SMALL BUSINESS.....	5
IMPROVING ACCESS TO FINANCE.....	11
ENHANCING THE BUSINESS ENVIRONMENT.....	23
RECONNECTING WITH MARKETS.....	33
LOOKING FORWARD.....	45
DVD INDEX .....	52

**LEFT:**An arbor full of Areni grapevines shades a pathway at a farm in Armenia's north.

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**INSIDE FRONT COVER:**Two carpenters from Armenia's north crafting a window frame in their workshop. MEDI helped this small business and others like it connect with markets and access financing to expand their operations.

© CHEMONICS / ZAVEN KHACHIKIAN

**FRONT COVER:**A morning view of Mount Ararat from Yerevan, the capital and commercial hub of Armenia. The city is home to more than 1.2 million of the country's 2.9 million inhabitants.

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**BACK COVER:**Traditional Armenian carpets hang outside a timeworn building in Yerevan. At one time, Armenia produced as much as 27 percent of the textiles sold in the Soviet Union. Today, Armenia's emerging small firms are rebuilding lost market connections.

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A baker in Gavar prepares the dough for Armenia's traditional bread, *lavash*, before baking it in a stone *tonir* (oven). MEDI worked with small businesses like this one, which are fueling Armenia's economic growth.

# EXECUTIVE SUMMARY

## A TIME OF TRANSITION

Armenia's economic recovery in the wake of the Soviet collapse has been turbulent. During the 1990s, Armenia suffered an estimated 60 percent decrease in gross domestic production (GDP) and hyperinflation of up to 11,000 percent. This economic breakdown caused a crisis in the banking system, and by 1998, more than half the population — 55 percent of some 3 million people — lived below the poverty line.

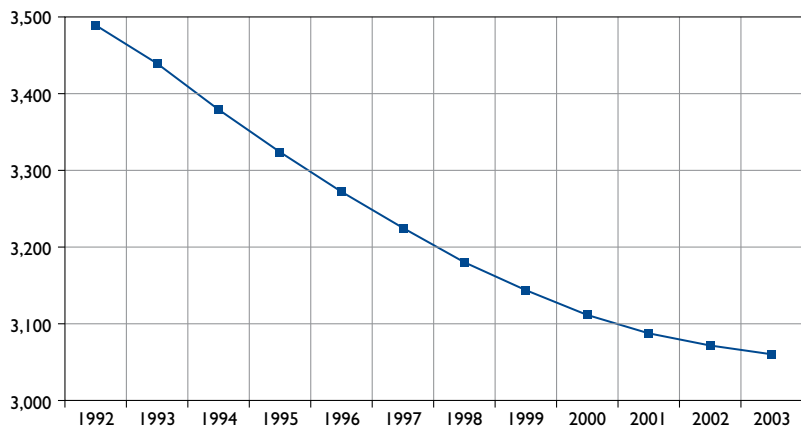
Ten years later, foreign investment and exports continue to lag behind those of Armenia's neighbors despite strong economic growth. Armenia's economic problems are aggravated by closed borders with neighboring Turkey and Azerbaijan due to a lingering dispute over the territory of Nagorno-Karabakh. This leaves two of Armenia's four international borders closed to trade, contributing to chronically high unem-

ployment. In addition, Armenia has lost up to 15 percent of its population since 1992 as those with skills move abroad in search of work. (see *Armenia's Shrinking Human Resources*, page 2)

To address these issues and help build a competitive private sector, the United States Agency for International Development (USAID) launched the Micro Enterprise Development Initiative (MEDI) in 2003. The aim was to create new opportunities for impoverished Armenians, especially those living outside the capital, Yerevan, by supporting the growth and development of small businesses. To promote growth, the project team looked holistically at small business needs: greater access to financial services, better connections with markets, and a more business-friendly environment. After three years of work, USAID has succeeded in its goal (see *Project Impact*, page 2).

## ARMENIA'S SHRINKING HUMAN RESOURCES

POPULATION IN MILLIONS



Source: FAOSTAT, 2005 (<http://faostat.fao.org>)

### PROJECT IMPACT

The MEDI team worked on three key small business needs in an integrated way achieving the following key improvements:

#### *Access to finance:*

- Introduced purchase order financing, enabling firms to borrow against confirmed orders, which injected at least \$5.8 million in short-term working capital into Armenian businesses.
- Brought investors and microfinance institutions (MFIs) together for a microfinance investors conference, facilitating realized and potential direct investments of more than \$7.2 million in Armenian and Georgian MFIs.

#### *A more business-friendly environment:*

- Facilitated legislative changes with the Central Bank of Armenia, leading to registration of three MFIs as universal credit organizations.
- Supported the opening of 10 Small and Medium Entrepreneurship Development National Center (SME DNC) branch offices that now serve small businesses in every Armenian *marz* (province).

- Developed and distributed more than 2,200 copies of the Entrepreneur's Roadmap business registration guide, contributing to a 52 percent increase small businesses registration and the creation of 23,000 jobs outside Armenia's capital, Yerevan, in 2005.

#### *Better connections with markets:*

- Developed a nationwide network of 33 certified MicroPlan curriculum trainers who now provide business skills training to Armenia's growing class of aspiring entrepreneurs and small business operators.
- Through project offices in the Tavush, Shirak, and Lori *marzes*, achieved maximum outreach to small and rural producers in some of Armenia's most remote rural areas.
- Achieved small business sales and investment growth of \$750,000, which translated into employment growth of 25 percent in client businesses and represented a \$7.50 return on USAID's investment for every \$1 spent.





**After the fall of the Soviet Union and the collapse of its command economy, factories like this one in Vanadzor, in northern Armenia, lost their buyers. Today, entrepreneurs assisted by MEDI are connecting with historic and new markets in the global economy.**

© CHEMONICS / CATE NORIAN

To ensure that the fruits of recovery reach a critical mass of citizens, transition economies such as Armenia's must continue to empower start-up and small businesses. Small enterprise development promotes social equality while harnessing the energy of one of the most productive segments of the

economy. The greatest challenge for governments and donors is to craft a cost-effective approach that combines broad outreach to small businesses with targeted assistance to increase their market penetration. This report provides examples and recommendations based on practical results achieved in Armenia.



Arega, a canning firm in Jervezh, is among the small businesses providing much-needed jobs and fueling Armenia's recovery. USAID launched MEDI in 2003 to create new opportunities for impoverished Armenians.



## CHAPTER ONE

# THE EMERGENCE OF SMALL BUSINESS

Small businesses are emerging as the backbone of Armenia's economic recovery. They provide hope and opportunity for the vast majority of the population and will continue to be the main vehicle for reducing unemployment and alleviating poverty. However, the slow pace of recovery has stunted Armenia's adoption of a true market economy, and small businesses continue to struggle.

Before the implosion of the Soviet system in 1991, Armenia's state-owned enterprises dominated the economy, accounting for more than 90 percent of GDP. But a devastating earthquake in 1988 and a series of setback in the early 1990s (see *Modern Armenia: A Turbulent Transition*, page 6) caused Armenia's decline from regional leadership to heavy dependency on remittances and small-scale agriculture. The wealth that once extended across Armenia became concentrated in

the hands of a few large business owners.

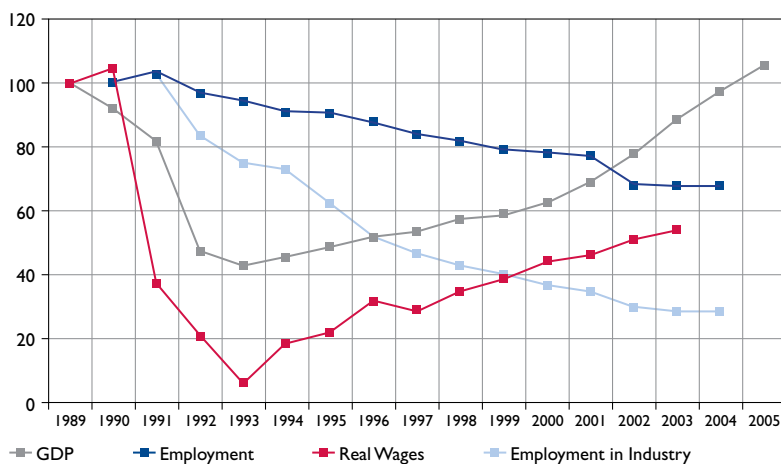
In the mid-1990s, the government embarked on an economic reform program that brought some stability and growth, but only in 2005 did GDP per person surpass 1989 levels (see *Employment, Real Wages, and GDP in Armenia*, page 6). During this difficult transition, small businesses emerged as an important segment of the economy, and by 2005, they accounted for 40 percent of GDP — more than double 1999 levels.

Armenia's economic recovery is far from complete, and small businesses continue to face significant challenges, including:

- A limited role in economic policy-making
- An underdeveloped and unstable financial system

## EMPLOYMENT, REAL WAGES, AND GDP IN ARMENIA

AS PERCENT 1989



Source: EBRD Transition Report 2005 (November 2005 and earlier editions); UNICEF, Trans MONEE 2005 (December 2005); and UNECE, Economic Survey of Europe, 2005 No. 2 (2005).

- Disconnections between buyers and suppliers in the market
- Unfamiliarity with free-market business principles
- Pervasive corruption

*USAID assistance.* Armenia's assets include a skilled and educated work force — 99 percent literacy with one in five holding an advanced degree — strong national identity, and political and financial support from the Armenian diaspora. The United

States Agency for International Development (USAID) has played a critical role in cultivating these assets by facilitating an increase in private sector employment, primarily among micro, small, and medium-sized enterprises collectively referred to in this report as small businesses (see *How Small is Small?*, opposite).

USAID launched the Micro Enterprise Development Initiative (MEDI) in 2003 to support small business growth and development. The aim was to create new

## MODERN ARMENIA: A TURBULENT TRANSITION

- 1988 – Earthquake in northern Armenia kills an estimated 25,000 and leaves hundreds of thousands homeless.
- 1989 – Conflict over Nagorno-Karabakh, a region in the neighboring Soviet republic of Azerbaijan, begins.
- 1990 – Armenian nationalists win parliamentary elections. Independence is declared, but ignored by Moscow.
- 1991 – A referendum sees 94 percent vote for secession from the Soviet Union. Armenia joins the Commonwealth of Independent States, the successor to the Soviet Union. Armenia recognized as independent by the US.
- 1992 – Armenia joins the United Nations. A trade and energy embargo is imposed by Azerbaijan. The conflict over Nagorno-Karabakh continues.



## HOW SMALL IS SMALL?

Commercial organizations in Armenia are classified as follows:

- Micro – up to 5 employees
- Small – 6 to 50 employees
- Medium – 51 to 100 employees

opportunities for impoverished Armenians, especially those living outside the capital, Yerevan. Chemonics International was selected to implement the three-year project, in partnership with Crimson Capital; the Day, Berry & Howard Foundation; echange; Making Cents International; the Microfinance Information eXchange, and the Microfinance Centre for Central and Eastern Europe and the New Independent States.

The project team crafted an approach centered on transactions. The team provided intensive assistance to help Armenian goods and service providers understand and meet the needs of buyers and investors. Focusing on transactions opened a window on the realities facing Armenian small businesses. Transactions also proved to be a reliable way to measure the effectiveness of project assistance. Over the life of the project, the team worked in three interrelated and mutually supportive areas:

- Increasing availability of and access to small business finance
- Improving the legal and

regulatory environment for small businesses

- Increasing access to markets for small business products and services

The next three chapters describe MEDI's approach to each of these areas in detail. Practical tools such as the *Entrepreneur's Roadmap: How to Register your Business* (page 28), activities such as the Micro-Plan business skills training (page 35), and systemic improvements such as regulation of the micro-finance sector (page 24) worked together to help small entrepreneurs grow and prosper. Yet much remains to be done. The final chapter recommends ways to build on USAID's support for small business growth in Armenia.

Throughout this report, individual stories illustrate the project's impact on small businesses. A typical client is Karine Ghukasyan, a small producer of a nutritional drink for children in her hometown of Vanadzor, in northern Armenia. Her ambition, tenacity, and community spirit are typical of Armenia's small entrepreneurs. Her story is on page 8.

- 1994 – Demonstrations in Yerevan over shortages of food and energy. An internationally brokered ceasefire ends the Nagorno-Karabakh fighting. The region is left a self-proclaimed republic.
- 1995 – The government launches a privatization and price liberalization program.

- 1999 – Gunmen open fire in the Armenian parliament. The prime minister, parliamentary speaker, and six other officials are killed. The gunmen accuse the government of leading Armenia into political and economic ruin.
- 2000 – Prime Minister Andranik Markarian admits that, 12 years on, those affected by the 1988 earthquake are still living in a disaster zone.

- 2001 – Armenia becomes a full member of the Council of Europe.
- 2005 – GDP per person finally exceeds 1989 levels.



Karine Ghukasyan distributes *narine* to orphans in Vanadzor, in northern Armenia. MEDI supported market research and helped develop new distribution channels to enable Ghukasyan's small business to expand.

© CHERONICS / CATE NORIAN

## SUCCESS STORY

# Beyond Profits

Health drink producer earns enough to offer discounts to orphanages in her community

Karine Ghukasyan's business in Vanadzor, in northern Armenia, grew quickly, but not quickly enough for her to begin using the profits to help her community — something she had always dreamed of.

The initial growth came after she applied modern packaging and branding techniques acquired on a U.S. study tour to her product, *narine*, a yogurt-like beverage popular with children. Her background as a physician and her previous work with a *narine* producer in Yerevan helped her secure the special licensing needed to give her company, Kara and Karen, a unique edge in the Lori *marz*, a market her competitors had been unable to penetrate.

But after a strong start, Kara and Karen's expansion stalled. Since *narine* is a highly perishable product with a short shelf life, Ghukasyan was uncertain how to approach new markets. She asked MEDI to help her devise a strategy to expand sales to neighboring regions.

Presentations to key buyers, including hospitals, municipalities, and retailers, revealed a need for consistent delivery schedules and careful product handling during transportation. To address this need, MEDI advisors linked Ghukasyan with a local supplier who provided customized boxing with small compartments. The project also helped Ghukasyan identify and organize key distribution channels in the Shirak, Tavush, and Kotyak *marzes*.

To mitigate the risk posed to retailers by the product's short shelf life, advisors helped Ghukasyan create a consignment sales scheme with no financial commitment from the retailer. Ghukasyan would take unsold *narine* back at no cost and use it for animal feed, reducing her capital losses.

This new strategy expanded her market share and tripled sales. "I have never experienced so much growth," Ghukasyan said. Business has grown to the point that Ghukasyan can now contribute to her community by offering her product at a discount to local orphanages and nursing homes. "This is only the beginning," said Ghukasyan. "I am confident that one day I will have a much larger factory and a diverse product line."





Construction workers labor in Meghri, a remote city on the Iranian border. Small businesses accounted for 40 percent of Armenia's GDP in 2005 — more than double 1999 levels.

© CHEMONICS / Zaven Khachikan





Vadim Usvitsky, general manager of the Small Enterprise Fund (SEF), plans his day. With MEDI's assistance, microfinance institutions like SEF tapped into new sources of debt and equity, enabling them to scale up lending to the small business sector.



## CHAPTER TWO

# IMPROVING ACCESS TO FINANCE

Relieving digestive discomfort is what Eduard K. Dilanyan has made his life's work all about. Dilanyan has had many offers from companies around the world for his patented food supplements. Until recently, he was unable to obtain the financing he needed to fill larger and more frequent orders, especially for export.

Dilanyan's dilemma – a lack of available financing appropriate for his business needs — is shared by many other small businesses in Armenia and is a recognized obstacle to economic growth.

With this in mind, the project team worked with top-performing MFIs to achieve financial sustainability, and with commercial banks to design lending products for small businesses. Both activities led to an increase in sustainable, nationwide access to small business financing. To identify

gaps and opportunities in the marketplace, the team carried out comprehensive research on credit supply and demand, including:

- In-depth institutional assessments of Armenia's top five MFIs
- A survey of Armenia's leading banks to assess opportunities to enter the small business finance market
- The first nationwide market study of small business credit demand
- An analysis of the legal and regulatory environment for microfinance

Armed with a solid understanding of the marketplace, the team worked with lending partners to craft and implement customized strategies to increase their capac-



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## SUCCESS STORY

# Financing that Fills Orders

In November 2004, with the help of MEDI, Eduard K. Dilanyan's firm Vitamax received the first purchase order finance loan in Armenia. A \$15,000 loan from Converse Bank enabled him to buy packaging and raw materials to fill a large order from a Ukrainian customer. Since then, Dilanyan has received several subsequent purchase order finance loans, enabling Vitamax to fulfill repeat orders and expand exports to Ukraine, Estonia, Latvia, Lithuania, and Japan.



### WHAT IS PURCHASE ORDER FINANCING?

Purchase order financing is a lending product that enables companies to fill purchase orders or sales contracts. When a company gets an order for its products, the lender advances sufficient funds for the company to buy materials, package the order, and ship it. When the customer pays for the order, the financial institution is repaid the amount advanced, plus interest and fees. Since a typical purchase order transaction is completed in 150 days or less, the company pays interest for only a short period. An additional benefit is that the purchase order or contract serves as collateral for the loan, thereby reducing the need for small businesses to pledge real estate or other fixed assets they often do not own or have already committed elsewhere.

ity to meet the financial needs of Armenia's small businesses. As this chapter details, this approach achieved results on many levels. Microfinance institutions improved their financial performance and outreach. Commercial banks developed and introduced new financial products. MFIs began to leverage commercial sources of debt and equity, which will fuel future financial sector growth. Most importantly, small businesses now have better access to a wider range of financial resources. The impact has been dramatic for entrepreneurs like Dilanyan.

### TRADE FINANCE

Until recently, it was difficult for small business to borrow from Armenian banks. As in most emerging economies, banks focused on large corporate clients and primarily used fixed-asset collateral to secure loans. But small businesses looking to expand often need more financing than their assets, such as real estate, gold, or cash, can support. Armenian banks perceived small borrowers as high-risk and usually turned them away or charged them extremely high interest rates. This left most small businesses with little or no access to financing, especially working capital. It also represented a lost opportunity for banks, which failed to tap into a profitable new lending market.

The project team saw a way to fill this gap by introducing purchase order financing to the market. Purchase order financing is a short-term, transaction-driven lending product that is especially

appropriate for small businesses. It provides working capital for the borrower while reducing risk and exposure for the lender.

One major challenge was to bridge the gap between commercial banks and the Central Bank. While Armenian law theoretically allows commercial banks to accept “alternative” collateral such as purchase orders, commercial bankers assumed that the Central Bank would refuse to accept alternative collateral and would classify such loans as “blank.” A blank loan is considered unsecured, and therefore, it must be one hundred percent secured by the bank’s own capital. This drives up the cost to banks and discourages them from making alternative loans.

However, after discussions with the project team, Central Bank officials confirmed that they would, in fact, allow alternative collateral, but such loans would need to be well documented. Central Bank officials said they needed to feel confident that commercial bankers were well trained in alternative lending procedures and risk management.

Understanding the concerns of both the Central Bank and partner banks guided project assistance. First, the team provided customized technical assistance to seven banks to help them develop new lending products — in particular, purchase order financing. Bankers were trained on the job to deal with actual loans to real clients in manufacturing, transport, construction, and agribusiness. Second, the project organized three trade finance

## INSTITUTIONAL CHANGES IN PARTNER BANKS

Bank	Increased Use of Trade Financing (Including Purchase Order Financing)	Increased Use of Alternative Forms of Collateral	Increased Use of Cash Flow Analysis in Lending Decisions	Adoption of New Trade Finance Policies and Procedures	Central Bank Approval of Bank's Trade Finance Policies and Procedures
Agricultural Cooperative Bank of Armenia	✓	⇨	✓		
Armenian Development Bank (ADB)	✓	✓	✓		
Anelik	✓	✓	✓		
Ardshinvest	✓	✓	✓		
Cascade	✓	⇨	✓	⇨	⇨
Converse	✓	✓	✓		
Ineco	✓	⇨	✓	✓	✓

✓ Yes ⇨ In Development

Source: MEDI

workshops for 49 representatives from eight major Armenian banks, as well 13 supervisors from the Central Bank. As a result, these banks dramatically changed their approach to small business clients. The table above summarizes the institutional impact of the assistance provided.

### *Making trade financing viable.*

Once partner banks began to show signs of improved capacity to analyze loan applications and provide purchase order finance loans, the project team turned its attention to formalizing policies and procedures with the Central Bank. A draft was developed to serve as a framework for new trade finance products.

In July 2006, Ineco Bank became the first Armenian bank to

receive Central Bank approval to use purchase order financing as a formal lending product. This was a major step for both Ineco and the entire banking industry. "Purchase order finance is a vital instrument for the banking industry right now," said David Sargsyan, head of banking, methodology, and analysis at the Central Bank.

*Impact.* Bankers trained by the project team provided at least 52 loans worth more than \$5.8 million to 35 companies. All of these loans were repaid on time, proving the viability of the lending product and the ability of partner banks to provide purchase order financing. The actual impact is much greater, since these figures represent only loans initiated during on-the-job



**“With the assistance of MEDI, our bank implemented a trade finance lending program designed around purchase order financing that has allowed our bank to be more flexible in structuring short-term lending products, in responding to immediate short-term financing needs, and ultimately, in helping to further develop the banking environment in Armenia.”**  
**— MHER GRIGORYAN, CHIEF EXECUTIVE OFFICER, INECO BANK**

training and do not include other deals concluded independently by the banks.

As a result of assistance, commercial banks have a new loan product to offer a growing customer base, and entrepreneurs like Dilanyan have a new, affordable business financing option. Together, they are helping Armenia’s economy grow.

### **MICROFINANCE**

Microfinance in Armenia originated with the support of the international donor community. In the 1990s, USAID and others helped finance and establish a number of MFIs. The goal was to alleviate poverty by supporting Armenia’s growing population of small businesses, most of which were subsistence-level enterprises operated by people driven to self-employment out of necessity. The financial needs of these tiny businesses were relatively straightforward. Most needed working capital loans no greater than a few hundred dollars to finance inventory purchases or basic raw materials. Except for MFIs, these micro businesses had few options for borrowing.

By the time USAID launched the MEDI project in 2003, the relevance of MFIs was being challenged. Armenia’s financial sector was changing rapidly. Banks were beginning to compete in some traditional MFI markets, and donor funding for microfinance began to dry up, forcing MFIs to access commercial investment to finance their future growth. Perhaps most importantly, legal and regulatory changes cast doubt on

the legality of most Armenian MFI lending operations.

*Laying the foundation for sustainable microfinance.* The MEDI project helped increase small business financing in four important ways. It:

- Strengthened the organizational capacity of MFIs to expand operations, reduce costs, and develop new products, helping to ensure their long-term viability.
- Improved the financial transparency of MFIs, making it easier for them to attract commercial investment. This is important because MFIs need to attract substantial resources to meet the demand for small business financing. This is not possible when they rely exclusively on donor funding.
- Fostered increased competition among MFIs. Competition improves quality of service while lowering prices.
- Supported formulation of new Central Bank regulations that brought MFIs into the formal financial sector and clarified their legal status.

*Building capacity.* An important way to increase access to financial services is to ensure that local financial institutions have the strategic vision, business plans, and internal capacity to expand on a sustainable basis. Institutional assessments

of five MFIs highlighted their strengths and weaknesses and provided critical feedback that led to new strategies for improving performance and extending outreach. Based on assessment results, the project team began working with four of Armenia's most prominent MFIs in 2004 to develop five-year business plans — the first such exercise for institutions like SEF (the Small Enterprise Fund, operated by World Vision). “The business plan was absolutely necessary for SEF at that time,” said Arsen Kuchukyan, SEF's executive director, “and what we have done and where we are now is completely in line with that plan. Without MEDI's assistance, change would have been slow, and maybe not so systematic or complete.” A detailed

account of SEF's transformation is on page 18.

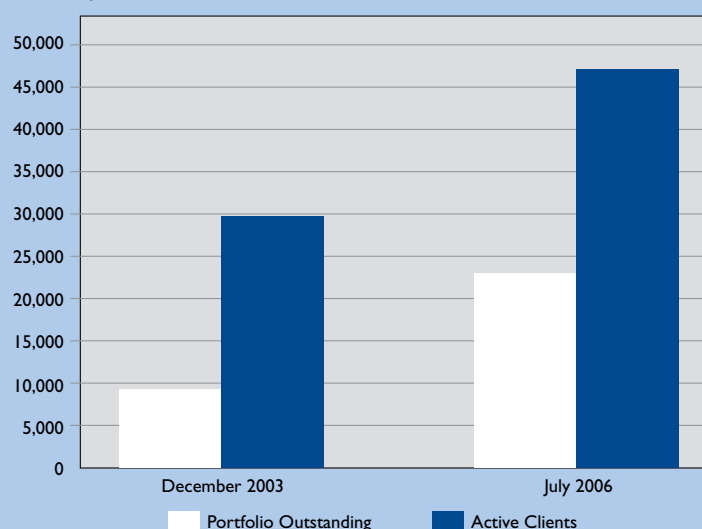
Bringing MFI senior managers together with a cross section of operations staff to develop each business plan created ownership and buy-in. In 2006, Mariam Yesayan, executive director of the Center for Sustainable Guaranteed Financial Assistance (ARE-GAK), said: “I think the fact that it was our initiative to update the business plan with MEDI this year speaks for itself. It means that we accepted, understood, realized, and appreciated the work that was done. We worked as a team. It was our business plan, not just MEDI's.”

Three of the four MFI business plans were approved by their respective boards of directors,

## LOAN PORTFOLIO, CLIENT OUTREACH JUMPS

MEDI's work with MFIs resulted in dramatic changes to the industry. One measure of success says it all — the growth of loans to Armenia's small businesses. As the chart to the right shows, in December 2003, shortly after MEDI entered the scene, the combined loan portfolio of Armenia's six MFIs was \$9.8 million, and their client base collectively totaled 29,686. By July 2006, the combined loan portfolio of the same group of MFIs had more than doubled to \$24.2 million, with a client base reaching 46,659.

U.S. IN \$ MILLIONS



Source: MEDI





**Mariam Yesayan, executive director of the Center for Sustainable Guaranteed Financial Assistance (AREGAK), says of MEDI's assistance: "I think the fact that it was our initiative to update the business plan with MEDI this year speaks for itself. It means that we accepted, understood, realized, and appreciated the work that was done. We worked as a team. It was our business plan, not just MEDI's."**

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# SUCCESS STORY

## Back from the Brink: The Armenia Small Enterprise Fund

Sound planning and better reporting  
save an Armenian microlender from  
bankruptcy

In 2003, the Armenia Small Enterprise Fund (SEF) was dangerously close to bankruptcy. SEF's survival was important not only to its 1,640 microloan clients, but also to other microlenders that would soon be required to convert from donor-funded nonprofits into regulated financial institutions. If SEF failed, other lenders might fail, too, and tens of thousands of small borrowers who relied on them would have nowhere to turn.

Against this backdrop, SEF approached MEDI to help it remain viable. SEF's staff, unaccustomed to competition with banks, at first didn't believe that SEF could fail if it did not change. "It was very important to get an independent opinion," said Vadim Usvitsky, general manager. An assessment found that SEF was only 52 percent operationally and 26 percent financially self-sufficient — far below benchmarks reported by the Microbanking Bulletin, a leading resource for comparative information on such institutions worldwide. At the time, the corresponding benchmarks in Eastern Europe were 123 percent and 138 percent, respectively.

To turn things around, SEF managers and staff worked with the project to develop a five-year business plan. One major objective was to attract commercial funding. A key step was reporting to the Microfinance Information eXchange (MIX), a leading provider of information on more than 700 microlenders around the world. Investors rely on MIX for an accurate picture of an institution's performance. With training, SEF submitted information to MIX and improved financial reporting so dramatically that it won the prestigious Transparency Merit Award from CGAP, a consortium of agencies working to expand access to financial services in developing countries.

By May 2006, SEF had reached its goal of becoming operationally self-sufficient, achieving a ratio of 106 percent — more than twice the previous level (52 to 106) — and had opened negotiations with several commercial investors. With a sound new strategy, improved transparency, and positive financial performance, SEF is back from the brink and on course toward a bright future of continuing to serve Armenia's microentrepreneurs.

*When the Small Enterprise Fund (SEF) was in financial trouble, "it was very important to get an independent opinion," said Vadim Usvitsky, general manager. With MEDI's assistance, SEF became operationally self-sufficient and won an award for transparency in financial reporting.*



**“MEDI provided very accurate assessments of the AREGAK program that helped in the identification of AREGAK’s future needs. [In 2004] there were some 19,000 borrowers accessing some \$7 million in loan capital. Those numbers have increased to 20,000 borrowers and \$9 million in loan capital, which is a great achievement. ... Guidance and direction provided to the senior staff of the AREGAK program was an enormous help in our effort to professionalize the program and staff in preparation for AREGAK’s future role in Armenia once AREGAK is entirely spun off from UMCOR.”**

**—WARREN HARRITY, EXECUTIVE DIRECTOR, UNITED METHODIST COMMITTEE ON RELIEF (UMCOR)**

and implementation is under way. The project assisted in the following ways:

*Upgraded information systems.* A strong management information system (MIS) is central to any MFI’s ability to significantly expand operations, develop new products, and scale up its client base. All three activities are essential for achieving long-term financial sustainability. Logically, each MFI identified MIS development as a top priority. The project worked with AREGAK and SEF to reengineer each institution’s MIS to enable them to upgrade their operations.

*Improved transparency.* The Microfinance Information eXchange (MIX) addresses one of the key challenges of the microfinance industry: the lack of reliable, comparable, and publicly available information on the financial strength and performance of MFIs. MIX representatives trained MFIs to

use MIX information exchange tools to produce financial information on their respective institutions in the MIX format. Using that information, MEDI produced Armenia’s first microfinance benchmarking report, as well as customized reports on several leading MFIs. “Collaboration with MEDI strengthened our ties with Armenian MFIs,” said Scott Gaul, MIX analyst for Eastern Europe and Central Asia. “It helped reinforce the importance of financial transparency and performance monitoring and led to a well-received benchmarking report.”

*Enriched human capital.* Four training courses were provided to 65 staff from three MFIs. The courses covered managing for improved performance, market research, strategic marketing, and loan analysis. Participants later shared the information with others who did not attend. “When staff go out for training, they come back and run some-

thing similar for other staff,” said Gagik Vardanyan, executive director of Microenterprise Development Fund Kamurj.

*Making microfinance viable.* Project assistance to MFIs culminated in a conference that connected interested investors with MFIs from Armenia and Georgia. The conference marked the moment that microfinance in these countries entered the financial mainstream and began integrating with international capital markets. Five international microfinance investors, two multilateral institutions, six Armenian MFIs, and five Georgian MFIs participated. According to Francios Rossier from Symbiotics, a Swiss-based consulting company that mediates investments in MFIs, “The conference was a good chance to network and look

at most of the Caucasus market in a short period of time.”

As a result of the conference, realized and potential investments of \$7.2 million were generated, including a \$300,000 investment in FINCA-Armenia from Oikocredit Credit, a Netherlands-based socially responsible investment bank. Project team efforts also encouraged a subsequent \$140,000 loan to SEF from the Jinishian Fund, an Armenian benevolent organization. “The conference was one of the most effective I’ve ever attended,” said Neleke Veenstra from Triodos, another Netherlands-based socially responsible investment bank. “The entire event was programmed around the investment climate and opportunities in Georgia and Armenia. This concrete program made the event super-efficient.”





An artisan working on a traditional Armenian gorg (a type of carpet) in Armenia's north. MEDI helped small entrepreneurs access a wider range of financial resources to expand their businesses.





Mkrtich Sakhanyan from Lukashen village in Armenia's fertile Ararat valley carefully inspects his cucumber crop. Sakhanyan received a mini-grant from MEDl to increase and diversify production.



## CHAPTER THREE

# ENHANCING THE BUSINESS ENVIRONMENT

Registering a business is a necessary first step for entrepreneurs all over the world. Registration enables businesses to operate without fear of being shut down or penalized, and governments benefit from an increased tax base. In developed economies, business registration is fast, easy, affordable, and fair. Not so in many developing economies, where the process can be slow, difficult, expensive, and subject to bureaucratic manipulation. This is especially hard on small businesses, which lack the resources to cope with inefficient or corrupt systems.

When Artzvik Petrosyan decided she was ready to move forward with starting a business in Martuni, a rural community located on the southwest corner of Armenia's Lake Sevan, she dreaded having to go through the daunting business registration process. However, she thought

having a sister who worked at the Registration Department would give her an advantage. This became less apparent after Artzvik and her sister, Tukhik Petrosyan, attended a training session in their hometown of Martuni. There, they learned about the *Entrepreneur's Roadmap*, a business registration guide developed by the project.

"Even though I work at the Registration Department, I was unaware of the many details mentioned in the *Roadmap*," said Tukhik. Like many civil servants, she is still learning how to interpret and apply many of Armenia's relatively new laws. Using the *Roadmap* helped Artzvik Petrosyan register her fitness center, which opened in February 2006 with classes for women and children. Tukhik Petrosyan gained a better understanding of the registration process, and now



To make her fitness center viable, Artsvik Petrosyan needed to register. She made use of the *Entrepreneur's Roadmap: How to Register Your Business*, a guidebook developed by MEDI.

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she provides better guidance to entrepreneurs who come by her office. “The book is very useful and has served me well at work,” said Tukhik. “Previously, I had to explain the steps to clients. Now I am able to recommend the *Roadmap* to them.”

The *Roadmap* was just one tool the project developed to smooth interaction between government and business. To foster a more business-friendly environment in Armenia, the team worked in three areas (described in more detail in the pages that follow):

- Addressed systemic issues that affected the entire microfinance sector

- Provided support to small businesses, especially in rural areas
- Reduced corruption and inefficiency in the business registration process

## MICROFINANCE

The previous chapter explained how the project worked to develop the institutional capacity of partner MFIs so they could meet the financial needs of Armenia's smallest businesses on a sustainable basis. Industry-wide interventions included improving financial transparency among Armenian MFIs and helping them access commercial financing. Simultaneously, the project



addressed systemic issues that were hindering overall development of the microfinance sector. The most important of these was the murky legal and regulatory status of MFIs.

The Credit Organizations Law, passed in 2002, created explicit rules for a range of new credit institutions, but it neither included the half-dozen MFIs operating as nongovernmental organizations nor explicitly exempted them. The law left these MFIs in limbo, with the legality of their operations in doubt. If government were to close these institutions down, thousands of microentrepreneurs would have nowhere to turn for loans, and the small business sector would be unable to fulfill its potential to contribute to the national economy.

The Armenian government needed to decide who the regulator should be. To expedite this critical decision, the project team worked closely with the World Bank, which conditioned a \$20 million poverty reduction support credit on government action to improve the enabling environment for microfinance. This conditionality provided an incentive for the government to act swiftly to select a regulator.

In early 2005 the Central Bank of Armenia, as the newly appointed microfinance regulator, asked the project to facilitate a working group. Acting as a conduit for the Central Bank, the working group, and the World Bank, MEDI provided critical technical input and ensured

that the needs and concerns of all parties were understood and addressed. Thanks to a constructive attitude on the part of the Central Bank and the working group, and to strong support from the World Bank, the Central Bank approved changes to the Credit Organizations Law that paved the way for Armenia's nongovernmental MFIs to register with the Central Bank. As of July 2006, five out of six MFIs had filed for registration, three had received licenses, and two licenses were still pending approval. Only one microlender had not applied for registration.

The practical benefits of having a clearly defined legal status became immediately apparent. MFIs began actively seeking commercial loans and equity investments, enabling them to scale up lending and improve their prospects for long-term financial sustainability. They have assumed their rightful place in the broader financial services market and are able to compete with commercial banks. "The Central Bank now sees us as a normal part of the financial system and has created an equal environment for us and for the banks," said Vadim Usvitsky, general manager of SEF. As a result, MFIs are now better able to support the growth of Armenia's smallest businesses.

## **SMALL BUSINESS SUPPORT**

Recognizing the growing importance of small business to the Armenian economy, the government formed the Small and Medium Entrepreneurship

### **SME DNC PROVIDES VITAL SUPPORT**

The SME DNC is the first Armenian state institution to support small businesses and link them with other government agencies and programs. It is governed by a board of 13 trustees representing government and the private sector.



**Gayane Hyusnunc and her husband, Simon, expanded their kiosk into a full-fledged store with a loan from the Small and Medium Entrepreneurship Development National Center. Supported by MEDI, the center's Charentsavan branch served 300 clients in 2005.**

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Development National Center (SME DNC) in 2002 (see *SME DNC Provides Vital Support*, page 25). Shortly thereafter, MEDI began supporting the center's efforts to fulfill its mandate. An institutional assessment and strategic planning session organized by the project helped focus MEDI's assistance and facilitate assistance by other donors, avoiding overlaps and gaps.

Of immediate importance for the SME DNC was to move geographically closer to its clients. The project helped open SME DNC offices in all ten *marzes* and create a system of communication among them.

Other assistance to the SME DNC included the following:

- Procurement of essential physical assets
- Improvement of accounting policy and procedures
- Development, design, and maintenance of an intranet, client database, public relations materials, and Web site (in coordination with UNDP, the United Nations Development Program)
- A study tour to the Czech Republic to examine successful models for incorporating small business

## VOICE IN POLICY MAKING

As an inaugural member of the Small and Medium Enterprise Coordination Committee, a donor coordination group, the project worked to revise Armenia's small enterprise development strategy. Round-table discussions focused on government's role in improving access to finance. More than 60 participants from government, business, and international organizations attended. This was one of the first times that Armenia's small entrepreneurs helped develop a state-level strategy to influence their livelihoods. Three focus groups made recommendations on improving government support for small business finance.

into trade and investment links (also in coordination with UNDP)

Previously, the SME DNC's poorly equipped branch offices had trouble attracting clients. Skeptical business owners didn't believe such barren offices could offer the services they needed to succeed. An institutional strengthening grant was used to procure computers, fax machines, furniture, telephones, and office supplies for distribution to branch offices. The change was dramatic. Visitors entering the branch office in the central Armenian city of Charentsavan, for instance, were suddenly greeted with ringing phones, humming printers, and buzzing conversations. "People here don't trust state organizations," said Gayane Arzumanyan, a business advisor in the Charentsavan branch. "But when they see that we have good furniture and office equipment, they believe we're serious. Then they begin trusting us with their ideas."

Among the 300 clients served by the Charentsavan branch in 2005 were Simon Hyusnunts and his wife, Gayane, owners of "Simon's Shop." Once a tiny food kiosk, Simon's Shop has grown into a small store, thanks to a loan from a local microfinance and assistance from the SME DNC. The couple approached the Charentsavan branch with the idea of expanding their kiosk. Utilizing the SME DNC's loan guarantee program, they built a new shop and stocked it with high-quality goods. A year later, their new shop was set to earn almost twice as much as their kiosk.

After just three years, the SME DNC had established an office in every *marz*, facilitating outreach to small businesses throughout Armenia. These offices assisted 4,500 small businesses in 2005. With its complete infrastructure in place, the SME DNC is poised to help create jobs and raise incomes on a major scale in some of Armenia's poorest regions.

## REDUCING CORRUPTION AND INEFFICIENCY

Armenia has a reasonably efficient legal process for business registration when compared to other regional benchmarks. But small business owners still face significant obstacles. As the story of Artzvik Petrosyan and her fitness center illustrates (page 23), would-be entrepreneurs balk at the prospect of registering under Armenia's cumbersome, and sometimes corrupt, bureaucratic system. In focus groups, entrepreneurs repeatedly cited the lack of information, and the prospect of dealing with ill-informed or dishonest civil servants, as major hurdles in the way of registration.

To fill this gap, MEDI designed the *Entrepreneur's Roadmap: How to Register Your Business*. The *Roadmap* explains many of the ambiguities and uncertainties surrounding the process of registration. Armed with accurate information, an entrepreneur knows exactly what fees are required and how long each process is likely to take (see *What To Do, Where To Go, How Long It Takes*, page 29).





Armed with the Entrepreneur's Roadmap developed by MEDl, Sylvia Elaryan was able to resist paying bribes when registering her consulting firm. Some 9,500 small businesses outside the capital registered in 2005, more than twice as many as in the previous year.

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# SUCCESS STORY

## Special Fees? No Thanks!

### Business registration guide helps curb corruption

Armenian entrepreneurs are vulnerable to petty corruption when they register a business. They often pay the equivalent of hundreds of dollars, when the actual costs are quite modest. Until recently, there was no guidance for entrepreneurs unless they were willing to read complex legal documents. Many balked at the prospect.

One such entrepreneur was Sylvia Elaryan, owner of a consulting firm called Aniroz in Ijevan, in northern Armenia. She was afraid to register her business until she purchased a copy of the *Entrepreneur's Roadmap* for 500 drams (\$1).

The *Roadmap* is a guide to business registration developed by MEDl and distributed by a network of small business assistance centers. The colorful, user-friendly guide includes an easy-to-follow map that offers illustrative and narrative descriptions of the procedures, costs, and time frame for business registering and licensing. MEDl developed the *Roadmap* after entrepreneurs in focus groups cited the lack of information as the biggest hurdle in the way of registration.

With the *Roadmap* in hand, Elaryan set out to register Aniroz. "I felt that I had a powerful weapon," she said. When confronted with several requests to pay "special fees" that were not listed as official registration costs, she politely declined, pointing to the *Roadmap*. She was able to register for the equivalent of \$60 — compared to the \$250 she had paid two years earlier when registering a different business.

Demand for the *Roadmap* has been strong. In 2005, around 9,500 small businesses outside the capital, Yerevan, registered — a 52 percent increase over the previous year. Providing approximately 23,000 jobs, these businesses are now part of the formal economy. They can operate without fear of being shut down or penalized, and the government benefits from a growing tax base. Most importantly, the *Roadmap* has given individuals like Sylvia Elaryan the confidence to register and operate legally. "I suggest that everyone use the *Roadmap* for registration," she said. "It's a valuable tool."

You are now legally registered  
and on the road to...



## What To Do, Where To Go, How Long It Takes

The *Entrepreneur's Roadmap* is a simple, colorful document that clarifies the costs and procedures associated with registering a business in Armenia. The user-friendly guide includes an easy-to-follow map that offers illustrative and narrative descriptions of the procedures, costs, and time frame for registering and licensing. It includes sample application forms, charters, board of director decisions, digests of laws and regulations governing the registration process, and contact information for all the offices connected with registration: the Tax Service, Social Security Fund, Customs Service, and more. The guide explains registration and licensing procedures for both sole proprietors and legal entities.

A key means of ensuring that the *Roadmap* was adopted and recognized as a legitimate source of information was consulting with the Ministry of Justice and the Ministry of Trade and Economic Development. In October 2004, the deputy minister of trade and economic development and the U.S. ambassador to Armenia publicly endorsed the *Roadmap* during an event to promote the guide. Following the event, the project and SME DNC conducted a series of road shows around Armenia and aired a series of public service announcements on television. The campaign increased awareness of the *Roadmap*, which continues to be distributed across Armenia through all ten SME DNC branches and the Yerevan office.

Alex Poghossian, managing director of Alpha Plus, a business consulting firm, uses the *Roadmap* to

help prospective clients register. Poghossian says business owners appreciate the simplicity and clarity of the *Roadmap*. “Usually, start-up entrepreneurs have an intrinsic fear of ‘legal or regulatory’ pieces of paper,” he said. “They want clear and straightforward guidelines, or a flow chart of what to do, and most importantly, what it will cost. This is how the *Roadmap* is constructed and why it is appreciated.” Once they have successfully registered, businesses often become good customers for Poghossian’s fee-based services.

In 2005, *marzes* outside Yerevan reported that approximately 9,500 small business registered — a 52 percent increase over the previous year. Most importantly, the *Roadmap* has given individuals like consulting firm owner Sylvia Elaryan the confidence to start a legally registered business. Her story is on page 28.





**Business advisor Gayane Arzumanyan, of the Small and Medium Entrepreneurship Development National Center's Charentsavan branch, speaks with a client. A USAID institutional strengthening grant from MEDI was used to procure computers, fax machines, furniture, telephones, and office supplies to help establish several SME DNC branch offices.**



Two employees of Shen Concern, a large wholesale dealer of construction materials in Yerevan, survey their work site. To capitalize on market opportunities, MEDI hosted a series of business-to-business meetings to improve linkages in the construction sector.



## CHAPTER FOUR

# RECONNECTING WITH MARKETS

**“As urban markets become saturated, more businesses are retooling their marketing strategies, and in many cases their products, to target rural consumers with tiny incomes but rising aspirations fueled by the media and other forces.”**

**—“BUILDING WEALTH BY THE PENNY,”  
WASHINGTON POST,  
MARCH 14, 2006**

Situated along the route of the Great Silk Road, Armenia has a rich history and culture founded on global trade. For centuries, this network of caravan trails served as a cultural and commercial conduit between East and West. However, Armenia's legacy as a hub of entrepreneurial and trading activity was broken by the Soviet-imposed centralized economic model. During Soviet times, many Armenian communities came to depend on jobs and incomes associated with a fragmented, inefficient centralized production system. Factories were located in far-apart republics, creating dependencies across vast distances. The collapse of the Soviet Union created new national borders, breaking production and distribution links between former republics. Communities and businesses surrounding large factories lost their economic anchor when these plants closed down, leaving large

population centers with little economic activity and major unemployment.

The ongoing transition to a decentralized market economy has created hardships for rural small businesses whose links to buyers in nearby markets have been severed or changed. Supply chains are being redefined. Exponential technological advances have converged with diminishing trade and political barriers, making it possible to do business instantaneously across the planet. A growing regime of international standards and other quality and quantity requirements has left many small businesses bewildered and intimidated. Finally, large multinational companies are expanding into markets like Armenia, forcing domestic businesses to compete for market share on their home turf. They must come up with inventive strategies to survive.



*Armen Matinyan stands at the loading dock of his company, Arevelk Trade Agency, LLC, which distributes bulk food to local retailers from Vanadzor, in northern Armenia. In just 10 months Matinyan was able to start his business, diversify his product line, and hire seven new employees, creating an annual turnover of \$270,000.*

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## SUCCESS STORY

# Café Owner Enters Bulk Food Market

### New business takes off when customers get the smaller packages they prefer

As a successful café owner, Armen Matinyan was on the lookout for the next great business opportunity. In 2005, he created Arevelk Trade Agency, LLC, to distribute bulk food to local retailers from his home town of Vanadzor, in the Lori region of northern Armenia. To his surprise, sales were sluggish. He was concerned about his company's growth prospects and sought MEDI's assistance in identifying untapped markets.

MEDI business advisor Suren Karapetyan, also a resident of Vanadzor, began talking to buyers to gauge their needs. "Potential buyers in Lori weren't interested in large quantities, but in smaller amounts that would spend less time on the shelf," Karapetyan said. With MEDI's assistance, Matinyan began to repackage and distribute bulk foods to retailers in his region.

With interested buyers identified and production shifted to meet their needs, Karapetyan worked with Matinyan to develop a distribution strategy. Beginning with Vanadzor and expanding to the nearby towns of Alaverdi, Stepanavan, Spitak, and Tashir, Karapetyan and Matinyan identified interested clients and established a weekly delivery schedule. Once the network was working and profitable, Karapetyan helped Matinyan expand beyond the Lori *marz* to include retailers in the neighboring Tavush *marz*.

After only 10 months of assistance, the company's annual sales had grown to almost \$270,000. Matinyan hired seven new employees, diversified his product line by partnering with local producers of juices and pastries, and purchased two delivery vehicles with financing facilitated by the project. Using his growing network, Matinyan plans to add seasonally popular products, such as fresh fruit.

MEDI's assistance in the northern economic corridor over 15 months supported 59 small businesses that, collectively, accessed financing and increased sales by more than \$750,000. "If it were not for MEDI, I would only be running my café, earning modest returns, and restricting myself to one market," said Matinyan.



As Armen Matinyan's story illustrates, opportunities are emerging for those who can provide the market with competitively priced inputs and services (opposite page). Through MEDI, USAID helped small entrepreneurs face the challenges of the modern marketplace by improving their business skills and reconnecting with domestic and international markets.

To provide meaningful assistance in a cost-effective way to the neediest entrepreneurs — primarily, those living in cities and villages outside the capital — the MEDI team partnered with regional business consultants to amplify project assistance. The project provided critical advice and tools while benefiting from local partners' knowledge and contacts. To determine the best ways to target assistance, the project team:

- Surveyed more than 700 small businesses throughout Armenia to determine what business services they required.
- Surveyed 80 business consultants throughout Armenia to identify resources available.
- Surveyed large and medium-sized businesses and identified more than \$40 million in demand for services and inputs that could potentially be supplied by small businesses.

The team adhered to one unifying principle: All project assis-

tance must enable small firms to exploit market opportunities. To achieve this goal, the team focused on two areas identified by initial surveys as needing the most attention: business skills development and market linkage facilitation.

## **BUSINESS SKILLS**

Nairi Shalunts, a successful exporter in Estonia, returned to his home of Goris, in southeastern Armenia, in the late 1990s to care for his aging parents. Although Armenia had declared independence and negotiated a truce over the neighboring territory of Nagorno-Karabakh, little else had changed. "Every week, another person would leave Goris," Shalunts said. "When we began working, there were no shops, no hotel, no taxi services, and no production." Shalunts established the Goris Business Center in 1997 with the goal of helping businesses in his community to turn things around. His story is on page 36.

Capitalizing on the desire and commitment of people like Shalunts, MEDI helped create a nationwide network of trainers certified to teach an internationally recognized business skills curriculum called MicroPlan. The curriculum provides a complete set of tools to examine a small business from a holistic perspective. It helps entrepreneurs assess demand, as well as the costs and risks associated with bringing their products and services to market. The project trained and certified 33 business consultants throughout Armenia in the MicroPlan curriculum,



*Consultant Nairi Shalunts found MicroPlan training to be exactly what his small business clients needed. Demand grew as satisfied customers spread the word. One client, a baker, increased sales by more than 30 percent after moving his oven to the front of his store to attract more street traffic — a strategy he developed during training.*

## SUCCESS STORY

# Facilitating Business Insights

Consultant offers practical, experience-based business training

Through colleagues, Nairi Shalunts, a business trainer in the southeastern Armenian town of Goris, heard about MicroPlan training of trainers offered through MEDI. This basic business skills course seemed to be exactly what his clients were demanding. "MicroPlan is easy to use, offers practical solutions, and is based on the reality of the entrepreneurs," said Shalunts, after participating in a course for trainers in summer 2004. "There will always be demand for such training."

Shalunts' consultancy, the Goris Business Center, had been relying on a lecture-oriented business course to serve clients, but MicroPlan changed that. An interactive course based on business simulations, MicroPlan draws from participants' experience to help them find solutions to challenges rooted in their own cultural and economic realities. Business owners examine their strategies and test new ideas in a realistic, yet safe learning environment.

As a certified MicroPlan trainer, Shalunts trained approximately 115 participants during 2005. They ranged from unemployed adults to entrepreneurs ready to start up a business. Demand for MicroPlan training grew as satisfied customers spread the word. "People talk about it with their friends or other family members and encourage them to attend," Shalunts said. One of his clients, a baker, increased sales by more than 30 percent after moving his oven to the front of his store, which attracted more street traffic — a strategy he developed during training. He now encourages all his business friends to seek out MicroPlan training.

Shalunts sees MicroPlan as an important part of the Goris Business Center's future. Another 80 clients in Goris had signed up for training as of May 2006, and Shalunts planned to organize training in each of the 12 surrounding villages. He also delivered training to a nearby business women's association and hoped to offer portions of the MicroPlan curriculum at a local university.

"MicroPlan has brought many clients to the business center who subsequently purchased additional services, such as training, individual consulting, and assistance with researching new business ideas," Shalunts said. With the help of MicroPlan, Shalunts hopes to continue growing his business and plans to enlarge his team of seven employees.



**Three businessmen from Georgia and Armenia discuss deals at the second of three business-to-business events in July 2005. In all, 276 participants from eight countries attended the three project-sponsored B2B meetings.**

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giving them a dynamic tool to assist small businesses in their communities. Trainers like Shalunts now have a marketable product and are able to provide higher quality consulting services. “The MicroPlan curriculum increased the reputation of our business center, and it became clear that participants in the trainings were satisfied,” said Shalunts. This led to increased business for Shalunts’ business through referrals from other clients.

Disseminating MicroPlan helped raise business training standards across Armenia and increase business owners’ confidence in the relevance of the services business consultants offer. To

institutionalize sound business training in the Armenian market, MEDI worked with the Professional Association of Trainers to strengthen its operations and integrate MicroPlan into its core service offerings. In August 2006, the association organized an expo where MicroPlan trainers demonstrated the curriculum to potential customers.

#### **MARKET LINKAGES**

Gaining access to markets is elusive for many small businesses. Struggling to make a living, they have difficulty imagining how they would approach larger partners to market their products and services. To overcome their doubts, the project team worked closely with



## B2B PARTICIPANTS GET DOWN TO BUSINESS

Trade show participants simply exhibit their products. At B2B events, participants meet with prescreened counterparts and conduct real business — that is, they buy or sell products and services. The format is simple. At a three-hour meeting, each participating business is given a table, four chairs, and a catalogue containing the profiles of each business in attendance. Preparation is critical.

The project sponsored three B2B events. Before each one, the team spent a great deal of time making sure that all relevant businesses in the sector throughout Armenia were contacted and invited. They helped each participant produce a profile detailing the products and services they were offering for sale or wished to buy. They helped participants register and narrow down the list of companies they were interested in meeting at the event. This ensured that the meetings made the best use of each participant's time and led to the transactions they were looking for.

many small businesses from remote regions to introduce them to larger buyers and help them meet the demands of these customers.

*B2B networking.* To capitalize on identified market opportunities, the project hosted a series of business-to-business (B2B) meetings to improve small business linkages in the construction sector (see *B2B Participants Get Down To Business* above). Construction is a significant contributor to the Armenian economy, encompassing firms ranging from raw materials to real estate, with the potential to capture a major share of the multimillion-dollar opportunity identified by project's demand assessment.

The project team developed a Web site for B2B information and an online registration process that allowed participating firms to create and share their business profiles. The site was an important tool for attracting international companies to project-sponsored events. To ensure

representation from as many small businesses as possible, the project partnered with local business consultants, who developed lists of local businesses and encouraged them to register and attend B2B events. The knowledge and insight these organizations brought was invaluable. They brought businesses to the table that had never used the Internet or even thought of marketing beyond their own localities. They helped alleviate the fears some small businesses expressed about Internet marketing. Finally, they helped facilitate deals and partnerships at B2B meetings and followed up with local businesses to make sure that any deals initiated were concluded successfully.

In all, 276 participants from eight countries attended three project-sponsored B2B meetings. Small businesses outside the capital began cooperating with related firms locally to secure volume discounts from large suppliers in Yerevan. They also learned to fulfill large orders by working together to



Shen Concern, a large wholesale construction materials dealer in Yerevan, concluded \$20,000 in new transactions with smaller companies as a result of MEDI's linkage efforts. Shen has since adopted a business-to-business model to cultivate relationships with small firms across Armenia.



*"Without USAID's help, our members would still be using primitive methods of farm management," said Emma Hakobyan, founder of a milk producers cooperative in northeastern Armenia. Training in farm management and bookkeeping enabled the Emulik Farmers' Cooperative to boost sales by 75 percent per year.*

© CHEMONICS / CATE NORIAN

# SUCCESS STORY

## Milk Money

**With focus on quality and new business savvy, producers find new customers**

It took Emma Hakobyan three years of collecting milk at her home from some 32 farmers before annual sales of her business, the Emulik Farmers' Cooperative in Ijevan, capital of Tavush province in Armenia's northern corridor, reached \$3,000. With project assistance, it took just nine months to triple the number contributors to the Emulik cooperative, resulting in an annual sales increase of 75 percent.

Hakobyan knew that buyers were the key to growth. "I heard about MEDI's services from a brochure I picked up at a local bank," she said. "I was interested in finding new buyers and in maintaining an efficient, balanced supply of milk."

Project advisors helped Emulik find new customers, including a major mozzarella cheese producer from nearby Ijevan who supplies the Yerevan market. They worked with Emulik's farmers to calibrate the efficiency of milk production to meet the fluctuating demand of various clients throughout the year. Training in basic farm management and bookkeeping helped farmers take control of their financial and business planning.

Training recipients used their newly acquired skills to manage output and calculate the amount of investment necessary to maximize production, including the purchase of new cows, feed, and equipment. When milk quality and production improved, orders increased, creating an incentive for more farmers to join the cooperative and share ideas and equipment.

Emulik used the fees paid by new member and profits earned from increased sales to purchase quality testing equipment. Advisors then helped Emulik find financing for a refrigerated vehicle so it could ship products beyond Tavush and fulfill repeat orders from larger clients.

Today, Hakobyan is confident that the cooperative's growth can be sustained. "We expect to have more farmers join as productivity and quality continue to improve," she said. "Without MEDI's help, our members would still be using primitive methods of farm management and would not know how to identify opportunities through cash flow analysis."





**Dina Manukyan provides MicroPlan business skills training to entrepreneurs in Masis. MEDI developed a network of 33 MicroPlan trainers, who continue to provide training throughout Armenia.**

© CHEMONICS / CATE NORIAN

increase capacity. After the B2B meetings, Yuri Avetisyan, director of a small construction firm in Martuni, got together with related firm owners in his region to fill large orders and negotiate more competitive sourcing discounts. “After the meeting, we had the idea to work together to meet big orders,” said Mr. Avetisyan. “We realized that because we are outside Yerevan, we can have a competitive advantage supplying local businesses. Now we have the means to compete with Yerevan companies.” The same group of firms diversified their products and got together to purchase more than \$10,000 worth of supplies from Ceramica, a large Yerevan firm, to meet three large orders.

Ceramica and other large firms have benefited from moving their products out to new markets. Shen Concern, a large wholesale dealer of construction materials in Yerevan, for example, con-

cluded \$20,000 in new transactions with smaller companies as a result of these linkage efforts.

The B2B model developed by the project has been shared with several other USAID projects in Armenia and used successfully. Shen Concern also adopted the model and now uses it to cultivate relationships with small businesses throughout Armenia and Georgia. “The B2B proved to be beneficial, as it allowed us to meet face-to-face with current customers, as well as establish relationships with new ones,” said Yervand Hovhannisyan, marketing manager for Shen. “As part of our marketing initiative, we now present our products and services to groups of interested buyers from all over the country, as well as internationally.”

*Economic corridors.* The project team used an “economic corridors” approach to promote small business development in northern

Armenia. This approach takes advantage of the fact that neighboring urban and rural areas are often the best markets for each other's products, services, and labor because they are linked by transportation systems. Corridors are an existing, but often underutilized, channel for spurring decentralized economic development in areas that can then connect to larger urban centers where larger buyers of goods and services operate. By jump-starting targeted businesses, the corridors approach directly increases the volume of economic activity in a sluggish economy like Armenia's north and creates secondary opportunities for supporting or competing businesses.

Armenia's northern corridor is the hub for regional commercial activity. It serves as the distribution point for goods entering or leaving the region and links northern Armenia with other corridors, larger commercial centers, and export markets (see *MEDI Activities Throughout Armenia*, page 48). By operating offices in the northern corridor and employing local business advisors, the project was able to increase commercial flows within and beyond the corridor.

Working with a local business consulting firm, Training & Development, Ltd., the project selected business advisors from each of three northern project office locations. The advisors were given a simple mandate: Help small businesses from each *marz* achieve sales growth at least three times higher than the cost of operating each of the three offices. The project of-

fered performance bonuses to advisors who exceeded their targets.

Advisors were trained to link small businesses to markets using the fundamental principle that demand drives supply, and producers must meet buyers' demands in terms of quantity, quality, and on-time delivery if they are to grow and create jobs. The approach can be summed up in the phrase, "Produce what you can sell rather than selling what you can produce." Rather than requiring advisors to focus on a single client, sector, or cluster, this flexible approach allowed them to figure out what the market demanded and seize opportunities as they arose. Advisors were encouraged to make decisions that would boost sales. This opened the door to creative, out-of-the-box thinking.

For instance, Aida Khachatryan, one of the project's business advisors, identified a doctor who wanted to produce plaster-of-paris cast kits to meet the needs of local hospitals. Khachatryan contacted a Chinese gauze manufacturer, a German machine tool maker, and a Swiss distributor. She worked with three local consulting firms and a textile manufacturer to make this innovative production possible. Had Khachatryan been restricted to a particular industry or focused on an objective other than boosting client sales, this opportunity might have been missed. "We were driven to find ways for our clients to sell their products," Khachatryan said. "In this way, I think we really provided a benefit to the businesses in our communities."





**Zarmayil Mardanyan provides consulting advice to a client. MEDI opened offices in three locations in Armenia's north, resulting in assistance to 59 small businesses that accessed financing and increased sales by more than \$750,000 combined in just 15 months.**

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What followed was low-cost, high-impact small business growth in some of the most remote regions of Armenia. Overall, this 15-month, \$100,000 investment in the northern corridor, closely monitored by MEDI, generated more than \$675,000 in increased sales and more than \$75,000 in increased investment for client businesses. The initial target of a \$3 increase in small business sales for every \$1 of USAID investment was more than doubled, at \$7.50 to \$1.

Like Khachatryan, the project's other two business advisors

achieved solid results, and all three went on to create their own business consulting firms in their respective *marzes*, employing the corridors approach as their core principle. Before MEDI, there were no sustainable private consulting firms in any of these areas. As advisor Suren Karapetyan put it: "The businesses I worked with would never have paid for the services I provided. Now, they are going to be my best customers." He gained their trust by producing results. "My clients used to ask me why I was there," Karapetyan said. "Now they ask where I have been."





A mechanic from Stepanavan, a rural center in Armenia's north, takes a break after a long day's work. By reaching out to rural entrepreneurs, MEDI brought small business owners and intermediaries in touch with concepts, resources, and markets they had not yet discovered or put to use.

## CHAPTER FIVE

# LOOKING FORWARD

MEDI addressed some major challenges faced by small businesses in Armenia and improved their prospects for success.

Nevertheless, starting up and running a small business is still difficult, and these difficulties hamper Armenia's growth and development. This report concludes with a review of what was learned from MEDI and some ideas for future assistance to help Armenia's small entrepreneurs grow and prosper.

### LESSONS LEARNED

*Amplifying impact.* Partnering with Armenian organizations and their employees amplified the assistance provided by the project. Their insights and resources exponentially leveraged MEDI's. These organizations were motivated to work cooperatively because the project helped them achieve their own goals and missions. Most importantly, these partnerships helped build a more

extensive, cost-effective, and sustainable network of support for Armenia's small businesses.

*Cross-fertilization.* The project addressed all major small business needs together and tackled obstacles to their growth holistically. This made the sum of project assistance greater than the individual parts. For example, the project's business advisor in Ijivan, Zamayil Mardanyan, was charged with creating market linkages, but he quickly realized that financing was a major obstacle for many of his clients. Taking advantage of relationships the project built with financial intuitions, Mardanyan helped his clients apply for loans, then used his business consulting expertise to help them solve their management and operational problems. His story is on page 46. It was not unusual for small businesses to receive both financial and busi-





*Zarmayil Mardanyan provides business advice to his growing list of clients. After working with MEDI as a business advisor, Mardanyan is turning the new skills he acquired into a successful consulting firm of his own.*

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## SUCCESS STORY

### Building on Success

It's not easy for small businesses in rural Armenia to obtain financing. Zarmayil Mardanyan should know — he has lived and worked in Ijivan, a remote mountainous region in the north, all his life. He gained his business experience running a successful grocery store that expanded into a trading company.

In 2005, Mardanyan became a USAID business advisor. In this role, he helped other small business owners identify new markets, obtain financing, improve efficiency, and boost production. While working with USAID, Mardanyan helped 32 clients secure loans of \$25,576 from local financial institutions and increase sales by more than \$44,000.

A typical client is Arshak Saribekyan, a small organic farmer who needed advice on marketing and obtaining a loan to boost production. Saribekyan said: "Zarmayil is very familiar with the market. He helped me apply for a small loan that will allow me to invest in my organic honey production line."

Mardanyan helped other clients obtain loans for vehicles, livestock, alternative products, and farm equipment, tailoring his assistance to match their individual growth needs. "Many small business owners make the mistake of acquiring loans without recognizing the conditions that go along with the investment," Mardanyan said. "They take a loan for too much money, spend it on unrelated products, and have trouble paying it back. I make a point of finding the best financial services according to my clients' needs. I also make sure they have a legitimate business strategy that will result in the highest returns on their investments."

After completing his USAID contract, Mardanyan started his own consulting firm, MarS Ltd. He uses many of the same methodologies he applied while working with USAID to help clients access financial services and identify market opportunities. He currently has six clients, including one potential foreign investor in a local dairy operation.

"I'm grateful to USAID for providing me the opportunity to gain a better understanding of my community's market potential and allowing me to learn from my colleagues," Mardanyan said. "In the past, I was the one asking for advice. Now, people are coming to me."



## MONITORING FOR EFFECTIVE MANAGEMENT

MEDI used its monitoring system for more than just reporting and verifying sales targets. Project business advisors tracked sales results to identify failures and successes in working with clients. Close monitoring enabled the advisors to spot problems and make mid-course corrections. The system employed an electronic, Web-enabled database built in Armenia that allowed daily monitoring of activities from any Web portal in the world. Daily sales and investment updates were verified by an independent monitoring expert. In this way, the system served as an ongoing, hands-on management tool, ensuring effective and efficient use of USAID funds.

ness consulting assistance from the project. On the macro level, the entire small business sector benefited from MEDI initiatives to clarify the legal status of microfinance lenders and to introduce new loan products.

*Maintaining clarity of mission.* MEDI's interest and focus remained squarely on improving small business. This helped the team stay on course when working with MFIs or other institutional partners whose short-term goals didn't necessarily match those of Armenia's small business sector or align with long-term trends in the financial services industry. Putting small business first allowed the project to serve as an honest broker, even when delivering unwanted news to counterparts, and to remain steadfast in its mission of improving the enabling environment for small businesses and increasing their access to finance and markets.

*Reaching out.* The vast majority of underserved small businesses are outside of Yerevan, and the project continually strove to reach out to them. The project team brought small business owners and intermediaries alike in touch with concepts, resources, and markets they had not yet discovered or put to use (see *MEDI Activities Throughout Armenia*, page 48).

*Accountability.* A good carpenter, it is said, measures twice and cuts once. An Armenian proverb takes this concept even further: Յոթ անգամ չափիր, մեկ անգամ

կտրիր (measure seven times, cut once). MEDI's best work resulted from incorporating impact measurement into implementation. Raising the bar to measure results proved a valuable management practice. Indicators were transaction-based (as opposed to industry or sector statistics) and measured not only outputs, such as the number of people trained, but also impact on the small business assistance recipient.

## THE ROAD AHEAD

Economic transition has accelerated, with Armenia ranking first in the World Bank's aggregate index on development progress in 2005. However, other indicators reveal continuing difficulties, and the small business environment is at a critical juncture. The project team continually encountered four specific areas where progress lags and small business growth has been stunted as a result.

- *A growing deficit of human capital.* Skilled labor migrating from small cities to secondary cities, and from these cities to Yerevan and overseas, continues to hamper small businesses production. Despite high unemployment, skilled labor, especially middle managers, remain at a deficit. Project team members continuously heard from small businessmen like Stepan Panosian, co-owner of a new chain of restaurants in Yerevan, that "we struggle to find qualified mid-level managers. It is one of



## MEDI ACTIVITIES THROUGHOUT ARMENIA

the biggest obstacles our business faces.”

- *Growing, but still inadequate, access to finance.* While small business finance has increased in recent years, much remains to be done. According to MEDI estimates, the aggregate portfolio of outstanding of loans of Armenian financial

institutions was about \$550 million as of July 2006. Given that nominal GDP in 2006 was expected to be around \$5.9 billion, the ratio of loans to GDP in Armenia was estimated to be around 9 percent, well below the average of 17 percent for the Commonwealth of Independent States, 29 percent for Eastern Europe,

and 120 percent for the European Union, all in 2004.

- *Continuing corruption.* More needs to be done to stem the tide of corruption, which hurts small businesses much more than large corporations. The latest report by global watchdog Transparency International suggests that corruption in Armenia has actually increased, with Armenia slipping from 82nd to 88th on its Corruption Perceptions Index between 2004 and 2005.
- *Low rate of economic activity outside Yerevan.* In 2004, MEDI statistics showed that Yerevan accounted for 83.4 percent of trade and economic activity in Armenia. Given that Yerevan accounts for only one-third of Armenia's population, this is an enormously disproportionate concentration of economic activity in the capital. Meanwhile, the gap between rich and poor continues to grow, pointing to an urgent need to increase market linkages between Armenia's urban centers and rural suppliers. These imbalances should continue to be the subject of intense focus by the international community, the diaspora, and other parties interested in Armenia's rural development.

## RECOMMENDATIONS

This report does not purport to provide a detailed design for future small business assistance.

However, setting MEDI's experience against the critical challenges previously described, three logical recommendations emerge.

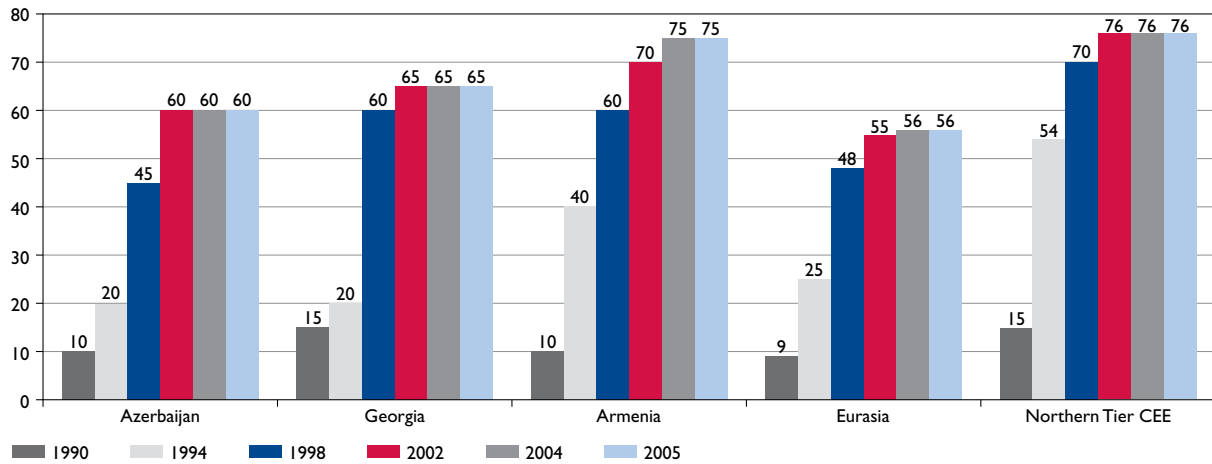
*Institutionalize small business advocacy.* Nothing would have a greater impact on small businesses in Armenia than the elimination of government corruption and patronage. Several small businesses MEDI worked with were severely hampered by difficulties with customs, opaque government procurement procedures, and an overbearing tax inspectorate — all of which caused several entrepreneurs to make decisions that, while rational in the short term, would have a negative long-term impact on sales and employment growth. Short of radical changes in the way government operates, an advocate or ombudsman for small entrepreneurs could play a key role in ensuring that their voices are heard, and that incremental changes are made to improve their ability to grow and prosper.

*Increase economic activity by engaging buyers.* The private sector in Armenia has grown to a critical mass over the past 15 years and now accounts for 75 percent of GDP (see *Private Sector Share of GDP*, page 50). Small business plays an increasingly significant role in the economy, especially in regions outside Yerevan. Long-term small businesses viability occurs when businesses can adapt their products and services to constantly changing market demand. Building capacity in marketing and sales, productivity, and financing ensures that



## PRIVATE SECTOR SHARE OF GDP 1990 – 2005

PERCENT OF GDP FROM PRIVATE SECTOR



Source: EBRD Transition Report 2004 (November 2004 and earlier editions).

small businesses have the skills and tools they need to identify and satisfy real demand. Similarly, the viability of intermediaries, such as business consultants and financial service providers, will be secured when they are able to offer high-quality services and generate revenues from non-donor sources. The market for business services in particular will grow only if demand grows. MEDI advisors in northern Armenia showed that it is possible to develop a sustainable demand for business services in a short period of time. All of Armenia's regions need to develop demand-driven

business services provided by consultants whose self-interest depends on promoting the growth and prosperity of their clients. Increased economic activity creates further opportunities for emerging clusters of financial and business service providers, technicians, and associated firms. As MEDI has shown, increased business opportunity in Armenia's rural areas, integrated cluster development, and accelerated economic growth occur best when assistance focuses single-mindedly on identifying buyers and helping small businesses meet their demands.



An Armenian woman prepares bread in the Shama bakery in Goris. After taking the MicroPlan training developed by MEDI, Arne Shalunts, the bakery's owner, made changes to his business that improved profits by 30 percent.

# DVD INDEX

**FINAL REPORT**

**SUCCESS STORIES**

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